

Corrected~~SECRET~~INDEXREPORT ON ECONOMIC DEFENSE POLICY

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July 7, 1955

REPORT ON ECONOMIC DEFENSE POLICY

Scope and Nature of Review

1. In accordance with a directive of December 22, 1954, from the National Security Council (NSC 5429/5, para. 7(c)(4), the Council on Foreign Economic Policy discussed generally the problem of economic defense and then formed a Task Force, consisting of a Steering Committee and a subordinate Drafting Group, to examine all phases of the problem. The initial NSC directive to the CEEP, passed down to the Task Force, called for a thorough review of present U.S. economic defense policy applicable to trade with the Communist bloc (including Communist China) and for such recommendations for revisions as might be required by national security interests, both long and short range. The Task Force has complied with this directive and offers for the Council's consideration a modified economic defense policy statement which it believes will serve best at the present time the over-all security interests of the United States.

Why Review Necessary

2. The necessity for the review stems both from the pressures of current problems and the fact that the last major survey of the program took place in August of 1953. Many international developments have occurred since that date, and there has been concern within the U. S. Government that the current program may possess certain major inadequacies. It is necessary to ascertain whether the policy as last approved by the NSC is flexible enough to encompass these and possible future developments. An immediate impetus for the review has been the problem of coping with the considerable pressure from our principal allies to plan to reduce the disparity in the levels of multilateral controls as applied

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against Communist China compared with the rest of the Soviet bloc as quickly as the international situation, especially vis-a-vis Communist China, would permit.

Background

3. In the summer of 1954, based upon an earlier NSC decision which had established the current policy, and guided by subsequent NSC directives for specific moves in the interim, the United States agreed to a considerable reduction in the multilateral level of trade controls applied to the Soviet bloc, excluding Communist China. This reduction was partly justified because change in circumstances with passage of time removed the necessity under the then applicable listing criteria, for continued control over certain listed items. Most important, however, were pressures from our allies, particularly the United Kingdom, to increase trade with the Soviet bloc. In order to avoid serious divisions endangering the multilateral cooperative effort, the U. S. agreed to revisions in the control systems which went significantly beyond the limits which the U. S. believed to be justified.

4. The NATO alliance had decided in late 1953 that the tensions upon which its war plans were based should be regarded as of indefinite duration. The export control program, however, continued to be based on the earlier NATO estimate of the likelihood of general war within a shorter period. Some reconciliation of these divergencies of posture was required; the list reduction was partly responsive to this need. The revision effected was recognized by the participating countries as putting the controls on a narrowed basis which they regarded as defensible and necessary for application throughout a lengthy future period. Since civil war was aflame in Indo-China, it was possible to confine the reduction to the European Soviet bloc. However, it was necessary even then, in response to

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Japanese requests, to agree that a high level review would be undertaken regarding the China trade control levels at a later time. Pressures were renewed and accumulated for such a review in the fall of 1954, after the Indo-China settlement, but Communist Chinese action in the Formosa Straits made it difficult for any country to press the U. S. for immediate change.

5. In view of recent developments in Europe which may lead to relaxation of tension between the European Soviet bloc and the West, and of the indications from Communist China, though far more uncertain, that relaxation might occur in Asia too, it becomes possible that in the next foreseeable period certain revisions in the control system may have to be seriously considered. An up-to-date economic defense policy should indicate the types of revision in the control system which the U. S. should be prepared to resist and the types of revision which the U. S. should be prepared to entertain, in the directions either of tightening or of relaxing the system, on the basis of reasonably predictable changes in circumstances. It is important, too, that U. S. policy be brought into this state of readiness as quickly as possible in order that the U. S. be in a position to retain initiative and leadership on any questions of major revision that may arise in the councils of the countries participating in the cooperative control organization. This delineation of policy must be shaped by economic defense considerations, but the statement of policy should also reflect a sufficient portrayal of the functions of the trade control program and an evaluation of its impact so that our highest authorities, looking at the trade control system in the context of our entire foreign relations, may be enabled to make an informed choice between objectives in this field and objectives in other fields, if such a choice should become necessary.

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6. The Task Force wishes to note in this connection, too, that its examination of East-West trade controls, and hence its recommendations as to policy, are circumscribed by the extent to which problems of East-West relations and, more particularly, problems of East-West trade, fall within its ken and competence; there are other aspects of East-West trade and obviously many aspects of East-West relations which lie within the jurisdiction of other policy-formulating bodies of this government. Some of these problems, such as the disposal of government-held agricultural surpluses, may be drawn together in the Council to which our report is now being submitted. Other aspects of East-West trade relations, such as those of a psychological warfare nature, may have to be coordinated with economic defense policy in the National Security Council itself.

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Current Control Program

7. The main features of the present economic defense control system applied by the member countries of the Consultative Group, including the U.S., are:

a. Towards the European Soviet Bloc:

On the basis of the 1954 List revision, the multilateral controls cover munitions and atomic energy items, and highly selected industrial equipment and materials virtually all of which are closely related to military production. There is a tight exceptions procedure for embargoed items. U.S. export controls go beyond the multilateral controls in that the U.S. embargoes items on the international quantitative list and about half of the items on the surveillance list, as well as a small number of additional items with respect to which the U.S. controls can be effective by themselves. In addition, the U.S. examines critically applications for export licenses required as well for all items not specifically rated for export control, and of the relatively small number of such applications presented has granted some and denied others. There are no import or financial blocking controls by the U.S. or the other participating countries with respect to the European Soviet Bloc.

b. Towards Communist China:

The U.S. maintains a complete embargo (i.e. export import, financial blocking and transportation controls) on transactions with Communist China. Multilaterally, there is an embargo on exports to China of all items on all the control lists for the European bloc plus certain additional items. In substance, production and industrial goods are covered, but not purely consumption goods. There are agreed exceptions procedures to the multilateral China embargo which have been increasingly utilized by the participating countries.

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c. Enforcement:

Coincident with the List revision, agreement was reached on improved enforcement techniques, particularly with respect to transit trade and transactions in controlled commodities through third countries.

8. A widely varying range of East-West trade controls is applied by countries which are not members of CG/COCOM. Some of these controls are founded upon bilateral understandings with the U. S. or upon multilateral agreements, including the United Nations embargo resolution against Communist China; others rest upon unilateral determinations of foreign policy, including a desire not to frustrate the efforts of friendly countries participating in multilaterally agreed control measures.

Summary of Courses of Action and Recommendations

9. There are four alternative directions in which the present above outlined economic defense control systems, both multilateral and unilateral, can be pointed:

First - retention of present restrictions.

Second - toward extension or tightening of restrictions.

Third - toward relaxation or reduction of restrictions against the European Soviet bloc.

Fourth - toward relaxation or reduction of restrictions against China alone.

10. The Task Force recommends:

a. That so long as current conditions of world tension endure, the present economic defense control systems be retained, with continuing primary reliance on multilateral cooperation, and with constant effort directed towards improvements in techniques and administration.

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b. Should the President, on the advice of the NSC, find that:

(1) conditions of world tension have materially worsened, then the second alternative should be adopted.

(2) conditions of tension between the Free World and Eastern Europe have materially lessened, then the third alternative should be adopted.

(3) Communist China has relinquished her posture of actual aggression which has hitherto set that regime apart from the rest of the Soviet bloc, then the fourth alternative should be adopted to the extent of establishing multilateral controls on a basis of general uniformity towards the entire Soviet bloc. The U. S. should then consider whether or not progressively to^{*} accommodate its controls to the multilateral control system in effect.

(4) the lessening of tensions described in (2) and (3) above both have occurred, then a combination of the third and fourth alternatives should be followed.

11. The above general conclusions rest on the following more particular findings and recommendations:

a. The economic advantage of East-West trade is greater for the Soviet bloc than for the Free World. All East-West trade increases the Bloc's economic capabilities relative to the West.

b. The maximum potential impact of trade controls on the Soviet bloc is limited; nevertheless, it is deemed significant to the security interests of the Free World.

c. The nature of the Soviet bloc economy and its system of allocating resources would indicate that the present criteria by which an

*/Commerce and MDAC recommend deletion of the bracketed language; Defense, State and Treasury recommend its retention.

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item is determined to be "strategic" or "non-strategic" and, therefore, subject to control, needs re-evaluation. Denial of those commodities, technology or services which impose the greatest economic cost to the Bloc would be an added factor in the criteria for determining which are "strategic".

Although the Soviet bloc economy is large and flexible, it is currently incapable of supporting from its own resources a mobilization base of sufficient magnitude to envisage the successful prosecution of a global nuclear war.*/

d. The greatest economic impact on the Bloc from trade controls would be achieved by utilizing every opportunity which the political and negotiating situation permits to enlarge the scope and severity of the controls.

e. Any attempt at broad extension of multilateral controls faces strong opposition from our principal allies, who still favor further relaxation.

f. Consideration of any change in controls must take into account both the economic defense impact of the change and an evaluation of its impact in terms of broad U.S. political objectives.

g. For the present, the scope and severity of the control program should remain approximately as now constituted.

h. The major courses of action which should be followed are:

- (1) Criteria: Intensified study should proceed on possible revision of criteria for placing commodities on the export control lists,

*/ Defense proposes inclusion of the bracketed paragraph as a second sub-paragraph under c. State, CIA and MDAC oppose its inclusion.

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including in such studies a detailed consideration of means for imposing the greatest economic cost on the Soviet bloc. The relative cost factor, if included within the criteria for "strategic" items, would not pre-determine the extent of coverage of the lists, which is a separate problem, but would tend to clarify the underlying rationale and better attune it to the achievement of maximum impact at any negotiable level of security trade controls. Most items on the current export control lists for Eastern Europe would be retained under control in any case because they have qualified for control under the elements of criteria which would still be retained.

- (2) Non-strategic Trade: The U. S. should refrain from encouraging "non-strategic" trade with the European Soviet bloc either by itself or by other Free World countries. However, the U. S. should approve shipments of such commodities from the U. S. where U. S. unilateral controls would not be effective.
- (3) Agricultural Commodities: These should be handled on the same basis as other items, subject to the considerations involved in resolving the more general problem of disposal of government-held agricultural surpluses.
- (4) China Controls: Present multilateral and unilateral China controls should be maintained to the extent possible at least until such time as the NSC makes a finding that Communist China is no longer an actual aggressor. Meanwhile, immediate study should be undertaken of a rationale and basis for a revised China control system for use at such time as the

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international situation makes an adjustment necessary or desirable.

- (5) Soviet Economic Penetration: Efforts to counter such penetration should generally be based on broad U.S. economic assistance programs, rather than on spot reactions.
- (6) Import and Financial Controls. U.S. import and financial controls should be maintained against Communist China, but should not be imposed against the European Soviet bloc. Long-term credits to the Soviet bloc should be discouraged.
- (7) Improved multilateral organization: The U.S. should seek means of strengthening the CG organization and consider its possible inclusion or closer alignment with NATO.

12. Amplifying the above recommendations, a reformulation of detailed policy has been embodied in the attached proposed revised statement of economic defense policy, which calls likewise upon the implementing agencies grouped in the Economic Defense Advisory Committee to give continuing attention to carrying out certain subordinate shifts in emphasis in the program and to exploring and, if possible, effecting various technical improvements in the controls system.

Particular Problems and Issues

13. Although the foregoing exposition outlines the general tenor of the Task Force's policy recommendations, it is believed it may be helpful to treat somewhat more specifically of certain of the key questions and problems studied in the course of the review. These questions and problems are dealt with at far greater length in the Staff Studies contained in the Appendix to this Report, but the following summary discussion of the individual problems will attempt to point out how the tentative resolution of these issues has been reflected in the proposed revised statement of policy.

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Evaluation of Objectives and Techniques of Selective Export Controls (See Staff Studies Nos. 1 and 3).

14. First and foremost, the Task Force has grappled with certain fundamental problems as to the objectives and scope of the trade control program (beyond the munitions and atomic energy material controls), the implications of intelligence evaluations as to its impact - present and potential - and the choice of techniques for best accomplishing the objectives which should be pursued. The attention of the Council is particularly drawn to the consideration of these issues, for their resolution affects in a major way the direction and flexibility of the economic defense program, defines a substantial portion of the future work assignment of the EDAC agencies and predetermines in large measure the negotiating problems that will be encountered in future operations under this policy.

15. This crucial analysis begins with the recognition of certain truths which heretofore may not have been very widely understood in the formulation or application of economic defense policy:

a. First, in aggregate terms, the economic advantage of East-West trade is greater for the Soviet bloc than for the Free World.

b. Second, subject to possible exceptions in situations dominated by non-economic factors, anything that increases trade between the Soviet bloc and the rest of the world increases the Bloc's economic capabilities relative to those of the West and vice versa. Hence, a complete stoppage of East-West trade would accomplish the maximum over-all loss of trade advantage to the Soviet bloc.

c. Third, to deny the Soviet bloc the import of a particular item does not inevitably mean that the Bloc will not be able, sooner or later, to replace

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this item. In other words, we cannot predict precisely where, geographically or functionally, the Soviet economy, which is large and flexible, will feel the impact of the embargo. It is, however, clear that the embargo imposes a permanent cost -- a cost which can be regarded as a retardation in economic growth of indefinite duration. The initial impact of this embargo is felt more sharply in that sector of the Bloc's economy to which the intended import would have made its direct contribution, but may also have a broader industrial impact if the item is in short supply.

d. Fourth, the impact of trade controls on the Soviet bloc--even if the economic cost were maximized through far more stringent controls than have been applied--is small, either in terms of inhibiting military build-up or of retarding relative economic growth, although the latter effect is relatively more significant in the case of the higher level of controls directed against Communist China. This impact, however, remains important to Free World security interests, largely because of the delays imposed, since the potential contribution of Free World exports would be utilized by the Soviets principally in the capital goods and military sectors.

16. The first implication of the above truths is that with respect to Eastern Europe the distinction in the current economic defense policy (NSC 152/3) between "strategic" and "non-strategic" trade as the control determinant is by itself inadequate, since any trade with the Bloc is on balance advantageous to the Bloc's strategic position vis-a-vis the Free World and denial of any particular commodity can be evaluated only in terms of its "cost" to the Bloc's economy. Secondly, the recent intelligence evaluation would indicate that the way for the U. S. to achieve the greatest economic impact on the Bloc from trade controls is to seek every opportunity which the political and negotiating situation permits to enlarge the scope and increase the severity of the control program. In contrast to

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current policy, this evaluation would tend to attach security importance to items on the basis of their relative cost^{*}/ whether or not previously classified as strategic or non-strategic. If not qualified by other considerations, this evaluation would require recasting of current non-strategic trade policy to an attitude of discouragement or, at most, reluctant acquiescence.

17. Regardless of the force of this analysis, a total embargo policy must necessarily be rejected at this time. First, a total embargo, or even a broad extension of the scope of control, would be strongly resisted by our allies. Their reasons would range from purely commercial considerations to their views of the requisite means for reducing international tensions. Even aside from the views of our allies, any proposal for a complete embargo would have to be weighed against our own views of the political and psychological effects of a trade control program of any given severity on international East-West tensions.

18. Given, then, a conclusion that trade controls toward Eastern Europe should remain on a selective basis, should they not, however, be greatly expanded in scope and severity in order to increase their impact in terms of economic cost? On the basis of all our experience, it must again be recognized that no major extension of the control system is negotiable under current conditions. Nonetheless, the Task Force believes U.S. economic defense policy should be to achieve the maximum impact, i.e., the greatest economic cost to the Bloc from trade controls, achievable consistent with the position of our allies and the international climate which obtains.

^{*}/The phrase "relative cost" refers to an appraisal of the relative contribution which various imports make to the Soviet economy. Employing this approach for the purpose of selecting the goods to be controlled, commodities or commodity groups would be differentiated in order of their relative scarcity or the relative difficulty (costliness) which the Soviet bloc would encounter in producing such goods at home as contrasted with obtaining them through foreign trade.

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19. The problem of carrying the above principle into practice is basically one concerning the techniques for application of the selective control concept. It should remain the task of the agencies concerned with implementing the economic defense program to explore and develop improved or additional criteria and techniques for the application of controls selectively to establish the degree of severity in the denial program which current circumstances permit in the way of avoiding significant contributions from the Free World to the Soviet bloc's economic capabilities for war.

20. Several techniques now under study offer some promise of advancing the effectiveness of the program, of rendering it more flexible and of avoiding some of the controversies experienced with our allies over the appropriate interpretation of the agreed criteria, or listing guides. One of these techniques is the relative cost approach (see Staff Study No. 1); another is the simplification of the control lists to deal with key categories of commodities instead of individual items. A variant of these techniques is the mobilization base approach, which, in attempting to measure scarcities of critical materials in the Soviet bloc, analyzes the relative gaps, in resources and time, between the current industrial base for military production and the base needed for all-out war production. This analytical approach could be applied selectively either to narrow or broad sectors of the Soviet economy. All these techniques, and others, should be seriously studied; explored with our allies, whenever feasible; and incorporated within the control system whenever found suitable for either unilateral or multilateral acceptance, whether as a substitute for, or a supplement to, the existing techniques.

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21. On the basis of the foregoing analysis, the Task Force has recommended, in the form of the attached proposed statement of policy,^{*/} continued adherence to a selective export control system geared to retarding the growth of the European Soviet bloc's economic capabilities for war, but with a fuller realization of the nature and true impact of such program, and with directions for work designed to improve and sharpen the program whenever consistent with changing conditions and opportunities.

Non-strategic Trade (See Staff Study No. 9)

22. There has been for somewhat over a year a persistent question as to the attitude to be taken towards so-called non-strategic trade, i.e., trade in commodities which are not included on the export control lists. Generally speaking, the European participating countries have favored the expansion and promotion of non-strategic trade. The United States, on the other hand, has tended to take a less enthusiastic attitude, emphasizing to other free world countries the pitfalls likely to be involved in expanding non-strategic trade with the Soviet bloc and refraining in this country from the active promotion of U. S. trade with the bloc. The existing U. S. policy directive (NSC 152/3) is somewhat ambiguous on the treatment of U. S. non-strategic exports. In paragraph 10 under "General Considerations" the policy authorizes a "gradual and moderate relaxation in the...practice of virtual embargo of shipments to the European Soviet bloc" taking due consideration of the effect of such relaxation on the total economic defense effort. On the other hand, in paragraph 21(b) under "Courses of Action" a "general rule" of approval for exports of items not on the U.S. MESL is clearly stated.

^{*/} See particularly paras. 1, 3, 4, 6, 10, 18a., 20, 22, 24, 25, 36d. and 37a.

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23. Our concern over trade in the items not included in the export control lists is heightened now by the foregoing re-evaluation of the impact of trade controls, which emphasizes the importance of relatively high-cost items. This re-evaluation might, after further inter-agency study, cause some revision of the present criteria so as to include the relative cost factor as an added criterion to aid in making selections for control. However, it has also become even clearer, since the adoption of NSC 152/3 and the August 1954 revision of controls, that there is little to be gained toward U.S. economic defense objectives vis-a-vis the European Soviet bloc by the embargo by the United States of commodities or technology which either are or would readily be shipped to the Soviet bloc from other free world countries. Accordingly, it is recommended in the policy paper that the general rule of approving exports to the European Soviet bloc of those items on the MESL not specifically identified for embargo and of all items not included on the MESL be clearly confirmed both in paragraphs 10 and 20c. This rule will have the effect of continuing the embargo from the United States of items on the international lists (except for some surveillance items) plus those few additional commodities whose flow to the Bloc can be effectively controlled unilaterally through the United States control system.

24. It will also permit the U.S., through unilateral restriction of its exports to the Bloc (direct and indirect), to impose an increased cost on the Soviet bloc either through forcing the Bloc to purchase available products in higher cost markets than the U.S. or through limiting the availability from the West to less than total Soviet bloc import requirements.

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Sufficient flexibility would also be maintained to deny or otherwise limit particular cases because of the special circumstances involved. Thus the U. S. export control system might operate so as to impose a further cost on the Soviet economy over and above that produced by the multilateral control system, while freeing the U. S. and international trade communities from relatively ineffectual control requirements. By narrowing the gap, however, between the export control practices of the U. S. and its allies, the revised policy would reduce current frictions between us and our allies, particularly with respect to the re-export of U. S. products.

25. Logically, the above analysis might be taken equally to impel the U. S. now to license, within appropriate limitations, exports of items on the international quantitative control list and certain items on the surveillance list. This approach may without serious effect be applied to the latter. However, the Task Force believes that for the U. S. to adopt this new course for items internationally agreed for quantitative control might seriously engender new pressures for relaxation in the multilateral control system, and this course therefore should not be undertaken at this time.

Treatment of Agricultural Commodities (See Staff Study No. 9)

26. The general rule of approval for U. S. exports to the European Soviet bloc of items not on the U. S. MESL, set forth in paragraph 10 of the policy paper, explicitly includes agricultural products. There are certain limitations on the general applicability of this rule to agricultural products which should be noted. Without going into the details of the policy and

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legislative decisions which serve as a limitation so far as U. S. exports of agricultural products are concerned (and which are dealt with in section A 3 of the Staff Study) it may be concluded that there are in practice only two possibilities at present for the U. S. export of agricultural products to the European bloc. The first is in the area of private transactions involving products acquired from commercial stocks rather than government stocks; the second is in the area of possible direct government-to-government sales for dollars when there is a clear advantage to the U. S. and no material injury to the trade of friendly countries.

Differential Controls Against Communist China

27. One of the central problems confronted in the review is what the outlook of U. S. economic defense policy should now be toward Communist China. As indicated above, the Task Force has found that U. S. security objectives, in both the political and economic defense aspects, call for the maintenance of economic, political and moral pressures on Communist China. A significant element of these pressures is furnished by the present higher level and wider scope of both the multilateral trade controls and the even more stringent U. S. export, import, financial blocking and transportation controls. Accordingly, the Task Force has found that under present conditions of world tensions, China controls should be maintained at least at their current levels. However, it is necessary that effort be undertaken now to establish more clearly the specific rationale which supports the current multilateral commodity controls and which will assist in preserving the more important aspects of such controls if pressures toward relaxation are significantly increased.

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28. At the same time it seems necessary to look ahead at possible developments in the fluctuating world tensions to assure that our economic defense policy will be sufficiently responsive to the changing needs of overall U. S. security interests. The more severe trade control treatment of Communist China followed the open assumption by that regime of the role of an actual, rather than a potential, aggressor. Future major downward adjustment in the trade control systems should depend on the event, which may or may not occur, of our making a finding that Communist China has ceased to be an actual, rather than a potential, aggressor. The Task Force recommends that the decision and timing involved in this sort of transition be reserved for the President and the National Security Council. Further, for such transition, the Task Force has not found it possible at this time to recommend the precise steps which should be taken in the adjustment of the control systems nor the timing which should govern each such step, and accordingly has recommended, in paragraph 37 of the proposed policy statement, only the setting of the general directions of the course of action to be followed.

29. If, on the other hand, tensions in the Far East should increase, as is entirely possible, the U. S. should be prepared, on indication from the National Security Council, to exert its leadership in inducing our allies to broaden and strengthen the existing multilateral control system in the direction of achieving maximum possible economic impact.

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30. In reaching these various conclusions and recommendations, the Task Force has been influenced particularly by the following considerations:

a. The higher level and wider scope of trade controls applied against Communist China do not, on the whole, deprive Communist China of any specific item available from the Free World to other parts of the Communist bloc, but do impose on Communist China a significant aggregate cost, estimated to run between 155 and 245 million dollars annually. The smallest part of this aggregate cost (estimated at a minimum of 30 million dollars annually) is a reflection of the costs of transshipment and procurement through Eastern Europe and of the inferior terms of trade resulting for the Chinese Communists from the differential controls (it must be noted that this portion of the aggregate cost of the differential controls could be increased if the Western European countries were willing to move toward its maximization by sincere efforts to avoid diversion to Communist China of exports ostensibly destined to Eastern Europe and by avoiding significant contributions to the transportation resources of the entire Communist bloc). A second portion of the aggregate cost, estimated 35 to 65 million dollars annually, results from the reduction in over-all trade between Japan and Communist China which is an indirect result of Japan's adherence to the multilateral control system. The largest portion of the aggregate cost of differential controls, estimated between 90 and 150 million dollars annually, results from the unilateral U.S. import and blocking controls, which have denied a significant unique market to Chinese Communist exports and which have cut off the flow of dollar remittances. */

*/In addition, there are approximately 100 million dollars in Chinese Communist assets blocked in the U.S. SECRET

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b. Except for Japan, the differential export controls hold relatively small economic significance for the participating countries, including the U.S. This fact highlights the essentially political nature of most objections to further maintenance of the control differential. The political attitude of our major allies in this respect is colored by their anxiety to realize a material reduction in international tensions and a greater belief than is shared by the U.S. that an increase in the scope of trade and commercial contacts between East and West will significantly facilitate this result. Some of the participating governments also feel strongly that the discriminatory trade treatment of Communist China is solidifying rather than weakening the economic and political ties between Communist China and the USSR. In this respect they feel that the differential in the multilateral controls is illogical, forcing the trade to pass through middlemen in Eastern Europe, contributing an aggravation in political relations and a domestic administrative burden, without accomplishing the denial of strategic goods to Communist China. For the U.S. also maintenance of the differential controls represents basically a political problem, particularly with respect to the multilateral controls, since these controls, epitomized by the U.N. Embargo Resolution, symbolize the Free World's united attitude against an actual aggressor and contribute moral and political, as well as economic, pressures toward an alteration in attitude of the Chinese Communist regime. The U.S., furthermore, has a different domestic political situation than does Western Europe with respect to economic measures against Communist China, since our people have felt more directly and sharply the human and economic sacrifices entailed for the Free World in prosecution of the Korean War and in bolstering the strength of non-Communist Southeast Asia.

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c. If and as future events contribute toward a further real or apparent relaxation in world tensions, the political problem presented by pressures for reduction of the differential controls will increase. Thus, for example, a Japanese foreign office spokesman has recently informed our Embassy in Tokyo that as soon as the international political situation will permit, his government will call for a meeting of the Consultative Group to consider replacement of the differential of China trade controls with a unified system at the COCOM level. Even prior to any such call for a CG review, we are meeting enhanced pressures on the level of the export controls in the form of increased requests in the Paris China Committee for exceptions from the embargo.

d. Were the U.S. now to participate in a multilateral adjustment of the China export control lists, our efforts toward retention of maximum impact consistent with political considerations would be hampered by deficiencies in the existing internal rationale for inclusion of items in an embargo toward Communist China. We need urgently to prepare our rationale and case for restrictions of the type and extent we should wish to see continued effectively against Communist China either in the form of a uniform list for the entire Communist bloc, with such exceptions as may be feasible and when it becomes timely to make that sort of transition, or in the form of a narrowed differential if adjustment becomes necessary prior to the time when, as a general approach, controls should appropriately become uniform for the entire Communist bloc. Unless we are so prepared in advance, we shall be unable to exert effective leadership toward the type of adjustment we should think necessary, in the face of obvious pressures to relax beyond the bounds of prudence and necessity. This is a problem which should engage the immediate attention of

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the implementing agencies in the economic defense community.

e. Finally, in any such future major transition in the control systems, the wisdom and timing of adjustments in U.S. unilateral controls will remain more clearly in our own hands. We must take due account of the fact that differences between our controls and the multilateral controls contribute to certain frictions with our allies. Such differences also derogate to some extent from the multilateral approach to an effective economic defense system. However, pressures from our allies against maintenance of unilateral U.S. controls will be slight, and our unilateral controls will not therefore be subject to all the same political considerations which may then induce an adjustment in the multilateral controls. The judgment basis for further maintaining U.S. unilateral controls should then rest on evidence of their continued effectiveness in imposing on the Chinese Communist economy significant costs additional to those imposed by the multilateral control system and on the political desirabilities or undesirabilities of relaxing these unilateral controls.

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Soviet Economic Penetration (See Staff Study No. 12)

31. During 1954 and 1955 the USSR has augmented its attempts at penetration of underdeveloped countries of the Free World economic development and technical assistance offers, in some instances linked to trade. While the Soviet offers thus far remain largely untested in terms of actual performance, the Soviets could probably supply technicians and significant categories of capital goods to less developed countries in instances where they might expect economic assistance would permit significant political gains. Since every grant of assistance to countries outside the Soviet bloc involves a sacrifice of domestic investment, the Soviets are not now likely to launch a large-scale capital export program.

32. It is clear that Soviet activities in underdeveloped countries should be followed closely and that the United States should be prepared to take such action as seems appropriate in particular cases. There are limitations on the extent to which the U.S. is able to counter specific Soviet efforts, and it must basically be assumed that existing U.S. foreign economic policies and assistance programs provide a general counterweight to Soviet economic penetration moves. Paragraph 36 of the policy paper makes this point clear. It provides additionally that the U.S. should insure that U.S. foreign economic policies and programs outside the specific export control field take account of the desirability of reducing as far as practicable the scope for successful Soviet bloc penetration moves, and that less developed countries should be made adequately aware of the nature and scope of U.S. assistance.

The proposed policy paper continues in paragraphs 12, 14, 29 and 30 the policy of attempting to reduce strategic risks arising from excessive dependence on the Soviet bloc,

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and in paragraph 29 states more clearly than was the case in NSC 152/3 U. S. readiness, within the limits of feasibility, to assist free world countries threatened with such dependence. It also fosters the provision of adequate safeguards against Soviet bloc manipulation of trade.

Import and Financial Controls Against European Soviet Bloc (Staff Study No. 10)

33. The question of whether import or financial controls applicable to the European Soviet bloc would be desirable was not dealt with explicitly in NSC 152/3. A limited problem of whether to restrict certain imports into the Free World from the Soviet bloc other than Communist China was, however, subsequently examined at great length within the EDAC structure. The result of that examination was interdepartmental agreement, at least with respect to the limited problem then under study, that it would be unnecessary and undesirable, under current conditions, for the United States to apply import or financial controls against members of the Soviet bloc other than Communist China. The question has been explored on a broader basis for this review (Staff Study No. 10), and paragraph 13(b) of the policy paper reaffirms and generalizes the earlier interdepartmental recommendation.

34. Several considerations on occasion have been advanced in favor of the U.S. imposing import and financial controls on the entire Soviet bloc. One is that such controls would deprive the Soviet bloc of the foreign exchange proceeds of exports and remittances from the dollar area. These receipts amount to about 65 million dollars annually. In addition, there are about 20 million dollars of Soviet bloc assets that are still unblocked in the U.S., which the bloc could be denied through imposition of complete foreign funds controls. Another argument

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which has been advanced is that such controls are necessary to deny dollar funds which Communist countries are using to finance propaganda and subversion in the Free World countries.

35. It is true that complete import and financial controls would **deprive** the Soviet bloc of some foreign purchasing power and of some dollar earnings. However, since no such control could be expected to be fully effective, dollars would still be obtained by the Soviet bloc for subversive or other uses. The loss of exports to the U.S. market could, to some extent (probably **roughly** about 25 million dollars), be made up by sales in other Free World markets. The total impact on the Soviet bloc, therefore, would not appear to warrant the establishment of the controls under current conditions.

36. A system of selected import and financial controls would be even less efficacious, and hence still less desirable at this time than the broad controls. An effort to apply U.S. import controls selectively only to certain Soviet products would be merely an arbitrary attempt further to curtail the present small volume of Soviet trade with the U.S. The bloc probably could evade the restrictive impact of such partial controls by substituting other products for export, and it would be difficult to demonstrate to the importers affected by the selective controls why they should forego the commercial opportunities of trade with the Soviets while other importers were permitted to furnish dollars to the bloc for the products which had not been nominated for this arbitrary discrimination.

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37. A further problem considered by the Task Force concerns the provision of credit directly or indirectly to the Soviet bloc for the purchase of Free World goods. While, apart from normal swing balances, such credit extensions currently have not been substantial, it is possible that commercial pressures and political considerations may lead a number of friendly countries to provide additional long-term credits in significant volume. Such action would represent a reduction in current cost to the Soviet bloc of the acquisition of imports so financed, and the Task Force believes that U.S. policy should be to discourage any trend toward substantial enlargement of such long-term credits.

Problems of Unity and Effectiveness in the Multilateral Organization
(See Staff Studies Nos. 11, 13, 14 and 15)

38. A key element in U. S. economic defense policy has been the desire to preserve an effective multilateral program for controlling exports to the Soviet bloc. The multilateral Consultative Group structure in Paris has been the organizational means for developing and carrying out a cooperative control program. The multilateral organization has been a highly useful and a reasonably successful venture and represents the heart of the multilateral program. It is perhaps to be expected that an organization which has been functioning continuously for over five years should develop certain stresses in its operation. The Consultative Group structure currently has a number of such stresses which come to the surface in connection with particular issues and which are indicative of some more basic differences in philosophy.

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39. One current indication of stress is the cumulative pressure of exceptions to the China embargo which could, if not curbed, result in seriously undermining the multilateral controls towards Communist China. The United States attempts to exercise appropriate flexibility as authorized in NSC 5429/5, but there are limits to the extent to which the progression of exceptions can be continued without basically altering in practice the agreed policy of more stringent controls towards Communist China. A further problem is that of developing a more meaningful quantitative control and surveillance policy with respect to exports to the European Soviet bloc. In a number of cases there has been failure to reach agreement on a List II quota, or the quotas agreed to have been unsatisfactory in the U. S. view. Little progress has been made toward developing effective List III surveillance techniques.

40. These problems are indicative of a passive or actively resistant attitude on the part of other participating countries. In this respect the United Kingdom, which is at once a leader and the principal opponent of increased controls, epitomises the problem. The United Kingdom, whose positive support is generally essential in obtaining favorable multilateral action on any important proposal, has steadfastly resisted all efforts to resolve the outstanding problems remaining from last summer's review in a manner which would be consistent with improved controls. If the United States were to reach the point where it is unable to make further multilateral progress because of this generally resistant attitude, it would have to choose between relinquishing part of its objectives or making greater resort to the inducements or pressures which are dealt with in Staff Study 11. The conclusions reached in the policy paper are that both types of device

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device may be appropriate and effective in selected instances, that inducements are generally preferable to pressures, and that there are distinct limitations on the usefulness of both: they may confuse and complicate other U. S. policies and programs, and may at time conflict with the voluntary multilateral approach.

41. The stresses which are currently apparent in the CG structure, therefore, cannot really be corrected by unilateral U. S. actions. Those stresses are indicative of a far more basic difference in philosophy between the United States on one side and most of the Western European participating countries on the other. The criteria for the listing of strategic commodities have been susceptible of differing interpretations. Even apart from the differences over criteria and basic procedures, there is no firm, agreed doctrine underlying the Consultative Group. The absence of a common philosophy has led to the aggravation of disagreements on specific issues now that the Western European countries regard the relaxation of world tensions as removing the overriding imperative for security trade controls. This deficiency in philosophical orientation has been analyzed in Staff Studies Nos. 3, 13, 14 and 15. Studies Nos. 14 and 15 explore particularly the possibility of curing the deficiency through a closer alignment or even consolidation with the NATO, which does have a recognized basic philosophy accepted by the members and is fundamentally oriented towards collective defense.

42. It is accordingly the recommendation of this paper, touched upon in footnote 3 in the attached policy paper, that further study be carried on of the possible advantages of associating the Consultative Group structure with the NATO in the terms initially set forth in Staff Studies 14 and 15, as a means of
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improving the unity and effectiveness of the organization.

Conclusion

43. In the light of the above considerations, the Task Force recommends that the Council on Foreign Economic Policy approve the attached proposed revised statement of policy and forward it to the National Security Council for their consideration. The Task Force also commends the Appendix, containing the Staff Studies, to the attention of the CFEP, and recommends that these studies also be transmitted to the NSC for their information and reference.

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